EXHIBIT 2

STAMP & RETURN

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Local Competition	)	CC Docket No 96-98
Provisions in the Telecommunications Act	)	
of 1996	)	

To The Commission

REPLY COMMENTS OF COX COMMUNICATIONS, INC.

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3. The Cox Model Meets the Need for National Standards Without Unreasonably Limiting the Ability or Incentive of Parties to Reach Negotiated Agreements.

The framework proposed in Cox's initial comments provides a model the Commission can use to equalize bargaining power. The Cox model is based on the principles adopted by Congress in the 1996 Act and is consistent with the statutory bias in favor of negotiations and State determinations in arbitrations.[38/] It also addresses the concerns raised by parties who object to national standards or who express concerns about the statutory price differentials causing arbitrage.

Under that framework, arbitrations would be governed by a set of standards, but negotiations would be subject only to the limits of Section 252(e). In an arbitration, the compensation for reciprocal transport and termination could range from bill and keep to LRIC, and the prices for unbundled elements could range from TSLRIC, allocated to individual elements, to FDC (in exceptional cases). States would to use bill and keep as a proxy for the costs of transport and termination and a specific model, such as BCM or the Hatfield study, as a proxy for the costs of unbundled elements when approximate cost cannot be easily determined. Bill and keep would be adopted as an interim compensation mechanism for transport and termination during negotiations and, if a state is unable to determine the appropriate compensation during the statutory 270 day period, until the state reaches a decision. Finally, all of a LEC's existing points of interconnection and all of its existing technical forms of interconnection would be deemed reasonable, as would any

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38/ This model is described in more detail in Cox's comments at 24-29. The specific terms used to describe the pricing boundaries for transport and termination and facilities obtained under Section 251(c) are defined in a glossary attached hereto as Exhibit 1. This glossary also was attached to Cox's initial comments.

interconnection that was available in at least the last 24 months preceding the request for interconnection

First and most importantly, the Cox model does not force negotiations to reach a preconceived result.[39/] The parties to any negotiation would be free to bargain away from the basic requirements if they so desired and if they believed that doing so would be mutually beneficial. At the same time, the model sets reasonable, binding boundaries for negotiations, so that neither party can expect unilaterally to impose an unreasonable result.[40/] This increases the incentives to bargain fairly from the outset.

Second, several parties object to national standards because they fear that such standards will not be adapted to individual circumstances.[41/] The model addresses this concern by setting boundaries that accommodate an individual ILEC's costs, rather than by depending on a national average.[42/] This approach gives States the flexibility to adapt arbitration results to the specific requirements of individual situations. At the same time, the model strongly encourages the use of proxies, which will make it easier for States to reach decisions in any arbitrations they may conduct.

39/ See, e.g., Comments of Massachusetts at 2; Comments of Maryland at 4.

40/ The reasonableness of the costing boundaries and technical requirements proposed by Cox is discussed in more detail in Parts II and III, below.

41/ See, e.g., Comments of Connecticut at 8; Comments of BellSouth at 36-38.

42/ The Cox model does not require the Commission to set a permanent single price that applies to all transactions. See Comments of AT&T at 46. Doing so would be contrary to the 1996 Act, which does not permit the Commission to set specific mandatory prices determined through the State arbitration process and which requires different cost determination mechanisms for reciprocal transport and termination and for facilities obtained through Section 251(c). See 47 U.S.C. § 252(b) (reserving right to make determinations in arbitrations to the States); Comments of Cox at 21-23 (describing distinctions in cost standards under Section 251(d)(1) and (d)(2))

Third, the Cox model demonstrates there is no risk of "arbitrage" between Section 251(b)(5) and Section 251(c) if the statute is interpreted properly. As shown in Cox's initial comments, reciprocal transport and termination and unbundled elements under the Cox framework are not substitutable for each other, so there is no opportunity for arbitrage.[43/]

Fourth, the model addresses the concern of several LECs that national technical standards could lock the telephone industry into specific technologies.[44/] This is unlikely to be a serious risk, given that new entrants are likely to have more advanced technology than incumbents. Nevertheless, the Cox model establishes only minimum technical standards that are based on the technologies in use at the time a request is made. This permits any carrier to implement new technologies in its network, or to negotiate with connecting carriers to upgrade the technology used for interconnection.

Fifth, the model avoids concerns created by certain other proposals in this proceeding. For instance, unlike USTA's proposal for standards for *bona fide* negotiation requests, the model avoids the pitfall of imposing detailed requirements on new entrants before they enter negotiations.[45/] The USTA standards would strangle competition by requiring too much information at the outset, in effect asking competitors to provide information they are unlikely to have until well after negotiations have commenced.[46/]

43/ See Comments of Cox at 33-36.

44/ See, e.g., Comments of SBC at 90-92; Comments of USTA at 11-12; Comments of Connecticut at 9.

45/ The USTA proposal is highly reminiscent of the process for obtaining "new" services under Open Network Architecture, which worked almost entirely to the advantage of the BOCs and has provided very few services purchased by enhanced services providers.

46/ Some of this information, such as specific points of interconnection, is likely to change in the course of negotiations, so requiring it before negotiations begin is pointless.

Finally, the Cox model avoids the one-sided bargaining incentives created by proposals that would set only floors or ceilings on compensation. Some commenters have proposed, for instance, using LRIC as a floor or FDC as a ceiling above or below which, respectively, any LEC price would be presumed reasonable.[47] However, any floor or ceiling, by itself, cannot create appropriate bargaining incentives because it constrains only one party. Indeed, "ceiling" proposals that entitle the LEC to any price up to the ceiling create little incentive for the incumbent LEC to bargain at all below that level. Both parties in a negotiation will have incentives to bargain only when there are meaningful constraints on the best result that both can expect. The Cox model, by giving both parties an incentive to negotiate and by putting limits on the results they can expect to obtain from arbitration, will achieve the results that Congress expected when it adopted the 1996 Act.

II. COX'S PROPOSED PRICING STANDARDS ARE CONSISTENT WITH STATUTORY OBJECTIVES, BASIC CONSTITUTIONAL PRINCIPLES AND SOUND PUBLIC POLICY. (Notice Section II.C.5 and Section B.2. and Section III. A

While many commenters in this proceeding recognized that reciprocal transport and termination and use of ILEC unbundled elements are two separate concepts,[48] ILEC comments universally muddied the waters between the very distinct differences in cost recovery for these functions that are reflected in the 1996 Act. The Commission accordingly

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47/ See, e.g., Comments of BellSouth at 5-6; Comments of Cincinnati Bell at 30-31; Comments of USTA at 49.

48/ See Comments of MFS at 80 ("MFS believes that Congress was unambiguously clear in establishing different pricing standards in Sec. 252(d)(1) and (d)(2) . . . ."); see also Comments of Teleport at 46-47 (calling for the use of forward-looking economic costs for pricing physical interconnection, unbundled network elements and collocation versus using bill and keep for pricing transport and termination); Comments of Sprint Spectrum and APC at 6-7 (discussing the different pricing standards of Sections 252(d)(1), (d)(2) and (d)(3)).

must be extremely clear in its rules to implement the obvious purpose of the pricing provisions and to ensure that the procompetitive intent of the statute is carried out.

A. Bill and Keep and LRIC Are Appropriate Boundaries for Arbitrated Compensation for Reciprocal Transport and Termination. (Notice Section II.C.5)

Section 252(d)(2) of the 1996 Act provides that an ILEC mutually exchanging traffic with a competing provider of local exchange service be compensated only for its "additional cost" incurred by this exchange. This additional cost standard demonstrates that Congress intended to minimize the compensation flowing from one local service provider to another for reciprocal transport and termination of traffic.[49/] Not only is this statutory standard unequivocal, it also makes sense. As the record reveals, where traffic is balanced between competing local exchange networks (and there is no reason to expect that it will not be), the transaction is an economic wash. Moreover, even where traffic is not in balance the additional costs for reciprocal transport and termination are minuscule and the costs of measuring or performing additional cost studies may well prove more costly than the provision of capacity to competitors. Moreover, transport and termination is not a one-sided arrangement — each carrier provides transport and termination for the other, and each benefits from the arrangement on every call because all customers want to be able to make and receive calls from all other customers in the area.

In keeping with this Congressional intent to keep charges for reciprocal compensation low, Cox's proposed boundaries for arbitrated compensation for reciprocal transport and

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49/ For this reason the Commission cannot accept the ILEC argument that "additional cost" is a floor and not a ceiling on permissible cost recovery for reciprocal transport and termination. See, e.g., Comments of Bell Atlantic at 35; Comments of Ameritech at 62. This is particularly the case because the *only* compensation *expressly* approved in the entire 1996 Act is bill and keep for reciprocal transport and termination.

termination are LRIC as one bound and bill and keep as the other. Cox further proposed that bill and keep be used as a cost proxy where the ILEC cannot or does not demonstrate additional costs.[50/] Where such costs can be demonstrated, they are appropriately limited to LRIC because LRIC reflects the actual cost of providing additional capacity and thus is the most accurate method for estimating "additional cost."[51/]

In contrast, a number of commenters suggest that TSLRIC is the appropriate standard both for reciprocal transport and termination and for unbundled elements and interconnection associated with unbundled elements. As Cox explained in its comments, however, Sections 252(d)(2) and 252(d)(1) simply do not permit such a generalized approach to two very distinct economic transactions governed by entirely different statutory costing standards. Unlike LRIC, TSLRIC is generally understood to include common costs associated with the decision to provide an entire "service."[52/] Applying such a standard is inconsistent with the statutory language of Section 252(d)(2) allowing only the recovery of "additional costs" for reciprocal transport and termination. It also is inconsistent with treating the exchange of traffic as a mutual benefit, which is what Congress contemplated in Section 251(b)(5).[53/]

50/ This cost proxy could be used on an interim basis during the pendency of negotiations and arbitrations, or as a permanent solution whenever the ILEC cannot or does not credibly demonstrate its additional costs using a LRIC methodology.

51/ See Comments of Cox, Brock Declaration at 6. This cost methodology includes a normal profit, as well, so there can be no question that it is compensatory.

52/ See Exhibit 1. For instance, the cost of a loop under the TSLRIC methodology would include an allocated portion of the costs common to the provision of local exchange service as a whole.

53/ As explained below, TSLRIC is an appropriate cost recovery standard for the provision of a service such as the purchase of unbundled elements or collocation with the ILEC.

ILEC commenters go even further and suggest that the Commission adopt a concept of cost based on Fully Distributed Cost ("FDC") methodology for transport and termination. FDC, however, includes not only common costs and overheads, but also embedded costs that are plainly impermissible costs for any calculation of additional costs for reciprocal transport and termination. The plain language of the statute does not permit inclusion of costs that would be incurred regardless of whether a carrier provided the requested transport and termination. Embedded costs, by definition, are already incurred and cannot be treated as "additional costs" of any future transaction.

While ILECs acknowledge, as they must, that bill and keep is an acceptable arrangement, they argue that bill and keep need only be made available if an individual ILEC "voluntarily" waives its rights to payment of additional costs and agrees to the arrangement.[54/] The statute, however, does not require such a "voluntary" waiver.

First, the bill and keep language plainly cannot be intended to apply only to negotiated, voluntary agreements because it is contained in the part of the statute concerning pricing standards to be used in arbitrations, not in the section concerning negotiated agreements.[55/] Second, there was no need for Congress to expressly permit the voluntary use of bill and keep. Given the predominance of bill and keep as an ILEC interconnection arrangement, it is highly unlikely that a State, in its review of a negotiated, voluntary bill

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54/ See, e.g., Comments of SBC at 52; Comments of Ameritech at 78-79; Comments of Bell Atlantic at 41; Comments of USTA at 79.

55/ Section 252(a)(1) and (e)(2) govern the submission of voluntary, negotiated agreements to State commissions that are judged under Section 252(e)(2)(A)'s non-discriminatory, public interest standard. In contrast, the Section 252(d)(2) pricing standard that contains bill and keep as an appropriate mechanism is the section that States are required to apply in judging the compliance of an ILEC with Section 251(b)(5) in an arbitration.

and keep agreement, would determine that such an agreement did not satisfy the non-discrimination and public interest tests that States must apply under Section 252(e)(2)(A).

Finally, basic statutory construction principles require that the Commission give effect to each part of the statute. Permitting ILECs to select, on a case-by-case basis, with whom they will voluntarily exchange traffic on a bill and keep basis would not only be blatantly anticompetitive, it also would render the Section 252(d)(2) instruction expressly permitting bill and keep — as an arbitration outcome — meaningless.

The ILEC opposition to bill and keep reflects their deep antipathy towards opening their monopoly markets. While ILECs have uniformly opposed bill and keep in State after State and in the Commission's proceeding to reform LEC-to-CMRS interconnection practices, they have never responded to the compelling argument that bill and keep is a good approximation of what actually would be charged in a competitive free market where the negotiating parties have equal bargaining power.[56/] They have failed to rebut evidence that the incremental cost of reciprocal transport and termination is extremely low, and is most likely offset by the expense of litigating actual costs and the administrative expenses inherent in creating the capability to measure and bill calls. They also have failed to establish that the Commission or the States lack authority to use bill and keep as a rate proxy for reciprocal transport and termination of traffic.

56/ See "Price Structure Issues in Interconnection Fees," by Gerald W. Brock, prepared for Teleport Communications Group, March 30, 1995. (Discussing that bill and keep is used by commercial internet providers and that the "best existing example of interconnection under competitive conditions without regulation is the interconnection of commercial providers of internet services.")

Moreover, ILEC arguments that mandating bill and keep would be an unconstitutional taking are wrong.[57/] Under either of the two standards the courts use to determine whether a taking has occurred, there is no taking in a bill and keep regime.

The first standard is whether there is a physical invasion of private property.[58/] While some LECs suggest that transport and termination is a physical invasion, that is not the case.[59/] Unlike Loretto, for instance, transport and termination does not involve placing the interconnecting carrier's property on ILEC property. It merely involves transmission of information from one network to another.[60/] In addition, even if there were a physical invasion, ILECs would be compensated under a bill and keep regime because they obtain the benefits of being able to terminate calls on the other carrier's network and of being able to receive calls that their customers want.

The other strand of takings jurisprudence — regulatory takings — is equally inapplicable to Cox's bill and keep proposal. A party asserting a regulatory taking bears a heavy burden and must prove that the regulation has a heavy economic impact and interferes with reasonable investment-backed expectations.[61/] For a taking to occur, the economic

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57/ See, e.g., Comments of Bell Atlantic at 40-43; Comments of BellSouth at 71-75; Comments of GTE at 56-59; Comments of USTA at 78-84.

58/ See Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982); Dolan v. City of Tigard, 114 S.Ct. 2309 (1994).

59/ See Comments of U S West at 29-32.

60/ Thus, the D.C. Circuit's physical collocation decision, which involved a government mandated physical occupation of LEC property, does not apply to bill and keep. Bell Atlantic v FCC, 24 F.3d 1441 (D.C. Cir. 1994)

61/ Penn Central Transportation Co. v. United States, 438 U.S. 104 (1978) ("Penn Central").

impact of a regulation must be so high as to render the property virtually worthless.[62] The loss of anticipated profits, for instance, is not sufficient to create a regulatory taking.[63] The underlying principle of regulatory takings law is that "[g]iven the propriety of the governmental power to regulate, it cannot be said that the Taking Clause is violated whenever legislation requires one person to use his or her assets for the benefit of another."[64]

Under this standard, Cox's bill and keep proposal does not create a regulatory taking. As Cox previously has demonstrated, the incremental cost of a bill and keep arrangement for transport and termination is extremely low.[65] If the balance of traffic is roughly equal, the benefit to the ILEC of being able to terminate calls on CLEC networks will keep pace with the increased cost, if any, of terminating calls that originate on competing networks. Indeed, as State commissions have found, the imposition of bill and keep will not result in an unconstitutional taking.[66] Equally important, the Cox model provides a specific mechanism

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62/ See Connolly v. PBGC, 475 U.S. 211, 223 (1986) ("Connolly"); Lucas v. South Carolina Coastal Council, 112 S.Ct. 2886, 2893 (1992); see also Penn Central, 438 U.S. at 136.

63/ See Andrus v. Allard, 444 U.S. 51, 66 (1979) ("loss of future profits — unaccompanied by any physical property restriction — provides a slender reed upon which to rest a takings claim")

64/ Connolly, 475 U.S. at 223.

65/ See Dr. Gerald W. Brock — Incremental Cost of Local Usage, March 1995 filed in CC Docket 94-54 on March 21, 1995.

66/ See, e.g., Washington Utilities and Transportation Commission v. U S West Communications, Inc., Fourth Supplemental Order Rejecting Tariff Filings and Ordering Refiling; Granting Complaints, in Part, Docket UT-941464 (released October 31, 1995) at 35 ("Bill and keep is not a system of interconnection 'for free'. Bill and keep is compensatory. There is a reciprocal exchange of traffic in which each company receives something of value.").

for an ILEC or any other carrier with excess inbound traffic to demonstrate and recover its incremental costs of transport and termination, which could be used if, for instance, a carrier is required to expand its capacity to accommodate increasing traffic received from another carrier.

Finally, Pacific Telesis argues that any rate that does not permit recovery of embedded costs is confiscatory.[67] This claim misstates and misapplies the law of ratemaking. Under those principles, rates are judged against "a zone of reasonableness" which is "bounded at one end by the investor interest against confiscation and at the other by the consumer interest against exorbitant rates" and the constitutionality of authorized rates is based on whether the financial integrity of the company as a whole is threatened.[68] There never has been a requirement that a particular rate be compensatory, as is evidenced by LEC claims that some of their existing rates are below cost and subsidized by other rates. The ILECs also have provided no evidence that a bill and keep regime for transport and termination, and particularly a regime such as that proposed by Cox that would permit a carrier to demonstrate that it had incurred additional costs, would threaten their financial integrity. They have not even made the case that they will incur *any* additional costs or that they will be unable to recover those costs from other sources. Accordingly, the argument that bill and keep cannot be mandated because it would be confiscatory is flatly contrary to both law and fact.

67/ Comments of Pacific at 66-67.

68/ Washington Gas Light v. Baker, 188 F.2d 11, 15 (D.C. Cir. 1950), cert. denied, 340 U.S. 952 (1951); FPC v. Hope Natural Gas, 320 U.S. 591, 605 (1944). In this inquiry, a court considers the final result of regulation, not the method used to reach that result. Id.

B. TSLRIC and FDC Are Appropriate Boundaries for Prices for Unbundled Elements and Section 251(c) Interconnection. (Notice Section II.B.2.)

As discussed in Cox's comments, TSLRIC and FDC, while violative of the statutory cost standards for reciprocal transport and termination, do satisfy the statutory standard for the States to apply in arbitrations to "bracket" acceptable ILEC pricing of unbundled elements and associated Section 251(c) interconnection. Under Section 252(d)(1), ILECs are entitled to recover their costs, and may also be permitted to recoup a reasonable profit, for unbundled elements. Both TSLRIC and FDC already include profit elements, and thus would guarantee an ILEC a reasonable return on its investment. In addition, TSLRIC and FDC would result in a greater cost recovery to the ILEC than a LRIC cost methodology. Applying a more generous cost standard to the provision of unbundled element services than to transport and termination not only reflects Congressional intent, it also is reasonable because the only benefit the ILEC derives from a carrier purchasing these services is the price paid for the unbundled elements and associated interconnection. This is in contrast to the mutual exchange of benefits received and provided by the reciprocal transport and termination of traffic, where the ILEC receives something of value in exchange for making its network available for transport and termination.

1. Incumbents' Objections to TSLRIC Reflect Inconsistent and Uneconomic LEC Expectations Regarding Recovering the Costs of Their Networks.

Several ILECs object to using TSLRIC-based methodologies for recovering the costs of interconnection and unbundled network elements. These LECs claim that prices set at

TSLRIC would be inconsistent with the 1996 Act[69/] or would disallow recovery of embedded historic costs purportedly necessary for continued LEC operations.[70/] The Commission should reject these arguments because they are inconsistent with the actual requirements of the 1996 Act.

First, TSLRIC is consistent with the 1996 Act. The statute provides little direction on how Section 252(d)(1) "cost" is to be determined except that it directly disavows rate-of-return based rates, *i.e.*, the regulatory regime which allowed automatic recovery of historic costs.[71/] Thus, there is nothing in Section 252(d)(1) that precludes the use of TSLRIC or requires that any historic costs be recognized.[72/]

Although some LECs claim that TSLRIC is constitutionally infirm, there is no constitutional entitlement for a regulated entity to recover historic costs.[73/] In particular, the Supreme Court has held that the due process clause "has not and cannot be applied to insure values . . . that have been lost by the operation of economic forces."[74/] Indeed, no LEC points to any case that requires recovery of embedded costs.

69/ See Comments of GTE at 76; Comments of USTA at 43-50.

70/ See Comments of Cincinnati Bell at 30-31; Comments of BellSouth at 57.

71/ 47 U.S.C. § 252(d)(1)(A).

72/ Indeed, TSLRIC is consistent with the Commission's own goal of pricing that "replicates market-based incentives and prices." See, e.g., Notice of Proposed Rulemaking, Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers, Dkt. No. 98-185, FCC 95-505 at ¶ 4.

73/ Comments of PacTel at 69-70; Comments of USTA at 47.

74/ Market St. Ry. Co. v. Railroad Comm. of California, 324 U.S. 548, 567 (1945)("Market St. Ry.").

Furthermore, the LECs are in no position to claim that they have any expectation of recovering their historic costs. Over the last several years many LECs have written down their telephone assets. These write-downs occurred because the LECs claimed that they did not expect to recover the full costs of deploying their networks in anticipation of competitive networks.[75] They cannot now claim to have an expectation that historic costs will be recovered, especially because investor expectations — the only expectations that matter — should have been adjusted in light of the write-downs.

Moreover, ILECs already have recovered a substantial portion (if not all) of their embedded costs. Even accepting the USTA claim that the adoption of TSLRIC would result in under-recovery of between $13 and $17 billion in embedded costs (an amount that is less than the anticipatory writedowns ILECs already have taken), these figures would constitute only a small fraction of the profits that LECs have earned. Over the past ten years, for example, the profits of the BOCs and GTE have exceeded $70 billion.[76] In light of these substantial and recurring returns, the LECs have no entitlement to additional returns on embedded costs in the future.

In addition, despite the incumbents' criticism of TSLRIC, there is no guarantee that TSLRIC in any particular case will yield a result less than FDC. The relative level of TSLRIC and FDC will depend on many factors, such as the relative costs of inputs.[77]

75/ Based on the SEC filings of the RBOCs and GTE, these writedowns exceed a total of $23 billion.

76/ This figure is based on review of the SEC filings of the RBOCs and GTE. Absent the writedowns noted above, total profits would have exceeded $93 billion.

77/ For instance, services that an incumbent provides that depend upon highly-depreciated assets may have relatively low fully distributed costs. In addition, some inputs used to provide a service, such as labor, are more expensive today than they would have

(continued...)

Finally, the Cox model, which uses TSLRIC only as a boundary, does not inflexibly constrain LECs from making a case that they should recover amounts over and above TSLRIC. Where an incumbent can show that TSLRIC would not be sufficient, it will have the opportunity to persuade a State commission that prices for unbundled elements should be calculated using FDC.[78] This will permit each State to make its own determination as to the appropriate level of incumbent cost recovery for unbundled elements.

2. There Is No Reason to Permit LECs to Recover More than the Fully Distributed Cost of Unbundled Elements.

Some ILECs suggest that the Commission should adopt a standard for pricing unbundled elements that permits them to recover their embedded costs plus some additional amount, either as "profit" under Section 252(d)(1) or on the basis of foregone monopoly revenues in the future.[79] There is no rationale to permit such an approach.

First, it is important to recognize that, as an absolute cost ceiling, FDC more than compensates a LEC for any cost it reasonably could expect to recover. FDC is based on embedded costs, *i.e.*, the costs the LEC has incurred, and includes profits calculated using embedded costs. Incumbent LECs have no legal entitlement to more than that.[80] Moreover,

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77/ (...continued)
been in the past. For services dependent upon these more expensive inputs, TSLRIC may lead to costs that are higher than FDC.

78/ While States should have the latitude to determine that some or all costs for unbundled elements should be based on recovery of embedded costs, Cox envisions that FDC would be the exception, rather than the generally applied standard.

79/ See, e.g., Comments of BellSouth at 56-57; Comments of Cincinnati Bell at 30-31; Comments of USTA at 47.

80/ Indeed, any price that exceeds fully distributed cost is likely to be too high and, consequently, legally impermissible because it exceeds the bounds of the zone of
(continued...)

as shown above, many incumbent LECs already have informed shareholders that they do not expect to recover all of their embedded costs by writing down the financial book value of their telephony assets.[81] Consequently, FDC is the absolute ceiling of what a LEC could reasonably expect to recover for unbundled elements or for Section 251(c) interconnection; any greater cost recovery would constitute an unjustified windfall.

The incumbent LECs' claim to arbitrated prices for unbundled elements that exceed FDC apparently is based on the presumption that incumbents must be made whole by their competitors for the impact of competition. As a legal matter, this is simply untrue — previous regulation is never a guarantee of future profits and the law does not protect a competitor from the effects of lawful competition.[82]

The idea that incumbents should be entitled to recover the monopoly profits they will lose as a result of competition is derived from the discredited efficient component pricing rule (the "ECPR").[83] Despite the Commission's tentative rejection of ECPR as a credible pricing method, several incumbents spend considerable effort in an attempt to rehabilitate

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80/ (...continued)
reasonableness. See Washington Gas Light v. Baker, 188 F.2d 11, 15.

81/ See supra page 26. In addition, BellSouth suggests that embedded cost and book cost are, in fact, the same. Comments of BellSouth at 56. To the extent that this is true, the written-down values of telephony assets on the companys' financial books would be the correct ones to use to determine embedded cost, not the values on LECs' regulatory books.

82/ See Market St. Ry., 324 U.S. at 566.

83/ The ECPR holds that a monopolist should be able to recover all of its expected monopoly profits from its competitors if those competitors must obtain some elements of their service from the monopolist The Notice correctly rejects the ECPR as an unreasonable pricing theory. Notice at ¶ 148.

it.[84/] Cox concurs with the comments filed by Professor Nicholas Economides, that demonstrate that ECPR effectively prohibits competition by making the bottleneck market a legal monopoly, whether or not it is a natural monopoly.[85/]

Finally, certain LECs suggest that the 1996 Act requires an explicit add-on profit element *above* FDC because Section 252(d)(1) mentions "profit" separately from "cost." The statute does not support this claim. First, "cost," as States and the Commission have applied the economic theory of TSLRIC and FDC, includes a return on capital. Clearly a return on invested capital is profit. Second, the statute does not require the inclusion of any profit at all — let alone the recovery of profit — in addition to the profits already reflected in either an FDC or TSLRIC methodology.[86/] It is ludicrous to suggest that Congress intended to entitle incumbent LECs to receive monopoly profits above and beyond the return on legacy investment. The goal of the 1996 Act was to benefit consumers by encouraging the development of competition in the local telephone market.[87/]

84/ GTE even attaches a "redacted" report rearguing the virtues of ECPR. See "An Empirical Analysis of Pricing Under Sections 251 and 252 of the Telecommunications Act of 1996," by Michael Doane, J. Gregory Sidak and Daniel Spulber.

85/ See Comments of Professor Economides at 6.

86/ See 47 U.S.C. § 252(d)(1)(B) (prices "may include a *reasonable* profit") (emphasis added).

87/ See S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. 1 (1996) at 1. (1996 Act is intended "to provide for a pro-competitive, de-regulatory national policy framework" that brings improved services "to all Americans by opening all telecommunications markets to competition").

C. The Commission Should Adopt Proxies as Defaults for Arbitrations. (Notice Section III.A.)

In addition to adopting boundaries for cost determinations under Section 252(d)(1) and Section 252(d)(2), the Commission also should adopt specific proxies that the States can use as defaults in arbitrations. As the 1996 Act suggests, proxies should not be derived from current ILEC rates, but instead should be based on reasonable approximations of their costs. Bill and keep is an appropriate proxy for the additional cost reciprocal transport and termination, while some form of the costing models mentioned in the Notice and by the Department of Justice could be adopted as a proxy for unbundled elements and associated Section 251(c) interconnection.

Proxies are appropriate for several reasons. First, they implement Congressional intent to base compensation on costs without resorting to traditional rate of return or intensive cost studies that depend upon easily manipulated LEC cost data.[88/] Second, they will reduce the burdens of arbitrations on the States. Reducing implementation burdens may be very important to States which have limited resources or which face numerous arbitrations.[89/]

Third, proxies will help to encourage good faith negotiations. In essence, proxies define "preferred outcomes" for negotiations, a technique that has been found useful by some States.[90/] Finally, proxies also give the parties something to bargain away from if they so

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88/ See 47 U.S.C. § 252(d)(1)(A)(i), (2)(B)(ii).

89/ Indeed, some states are expressing concern about their ability to implement the 1996 Act. See Comments of North Dakota at 1; see also Implementation of the Telecommunications Act of 1996, Tentative Decision, Pa. Pub. Util. Comm., Docket No. M-009 (Mar. 14, 1996), at 5-8.

90/ Comments of PacTel at 94.

desire. For instance, a new entrant might agree to transport and termination compensation that exceeds the proxy in return for favorable rates for collocation or unbundled loops. Giving both parties additional "bargaining chips" through the adoption of proxies will greatly enhance the ability of the parties to reach an agreement.

The Commission can achieve these benefits, however, only by defining specific proxies. The proxies should be based on approximate, forward looking costs, and should not be based on current prices for access or other LEC services.[91/] Using approximate forward looking costs is consistent with the requirements of the 1996 Act and also prevents incumbents from obtaining bargaining leverage from insisting on proxies that are set too high.[92/]

This approach makes bill and keep the ideal proxy for reciprocal transport and termination because it is a good approximation of actual costs. As Cox and others have established, the actual costs of transport and termination are quite low.[93/] At the same time, if traffic is in balance (or close to balance) the net cost of obtaining transport and termination

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91/ Access rates are a particularly poor proxy because, as even incumbent LECs concede, they far exceed cost. Any effort to remove the non-cost elements from an access-based proxy is far less likely to yield an appropriate rate than will a forward looking cost method. Comments of Cox, Exhibit 3, Brock Statement at 6. Moreover, existing access rates were determined using rate of return methodologies, which is inconsistent with the 1996 Act's cost standards. 47 U.S.C. § 252(d)(1)(A)(i), (2)(B)(ii).

92/ 47 U.S.C. § 252(d). If proxies are too high, incumbent LECs will gain additional bargaining leverage. The risks of setting a proxy too low, on the other hand, are small. Not only do new entrants have very little bargaining leverage to begin with, but a proxy that is too low will create an incentive for the incumbent LEC to produce the information necessary to support a more accurate cost determination. If the proxy is too high, it is unlikely that the incumbent would ever produce contrary information.

93/ See "Incremental Cost of Local Usage" by Dr. Gerald W. Brock, filed in Dkt. No. 94-54 on Mar. 21, 1995; Comments of NCTA at 55; Comments of TCI at 35-38.

is zero (or minuscule), regardless of the actual cost for each unit of capacity.[94] Thus, bill and keep is likely to approximate the results of any objective determination of the costs of transport and termination.

The Commission also should adopt a cost-based proxy for the costs of unbundled elements and Section 251(c) interconnection. A TSLRIC based cost model, such as BCM or the Hatfield model, would be ideal. Most important, models allow for variation from carrier to carrier and geographic area to geographic area because the inputs can be varied. This avoids the problem of "one-size-fits-all" pricing that concerns some commenters.[95] At the same time, use of a model such as the Hatfield model that is largely or entirely based on publicly-available inputs (such as ARMIS data) will permit any interested party to evaluate relevant incumbent costs, which will aid them in negotiations.

III. THE COMMISSION MUST DEFINE BASIC TERMS AND CONDITIONS FOR NEGOTIATIONS UNDER SECTIONS 251 AND 252. (Notice Section II.B.2, Section II.C.5, Section II.C.2.e.2, Section II.B.1, Section II.C and Section III)

A. *The Commission Should Not Permit the Imposition of Separate Interconnection Charges on Carriers Reciprocally Exchanging Traffic for Transport and Termination.* (Notice Section II.B.2 and and Section II.C.5

The Commission must straightforwardly establish that reciprocal compensation for the exchange of traffic between a facilities-based competitor and an ILEC is not conditioned on any separate Section 251(c) interconnection charge. Contrary to the assertions of some ILECs, transport and termination for the mutual exchange of traffic is a self-contained

94/ Comments of MCI at 51-53.

95/ See, e.g., Comments of PacTel at 26.

CERTIFICATE OF SERVICE

I, Vicki Lynne Lyttle, a legal secretary at Dow, Lohnes & Albertson, PLLC do hereby certify that on this 16th day of December, 2003, copies of the foregoing Comments of Cox Communications, Inc. were served by hand-delivery to the following:

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